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Subject: State aid SA. 36047 (2013/N) – Lithuania
Fifth prolongation of the Lithuanian bank support scheme - H1 2013

Sir,

I PROCEDURE

(1) On 5 August 2010, the Commission approved a State aid scheme ("the scheme") in support of the Lithuanian banking sector, consisting of three measures ("the measures"), namely State guarantees for bank stability enhancement (the "guarantee measure"), Subordinated loans to banks (the "recapitalisation measure") and Redemption of bank assets (the "asset relief measure") by its decision in State aid cases N 200/2009 and N 47/2010 ("the original decision")[1].

(2) On the basis of subsequent notifications, the Commission approved the prolongation of the scheme on four occasions in its decisions of 21 January 2011 in State aid case SA.32188 (2011/N)[2], of 27 June 2011 in State aid case SA.33135 (2011/N)[3], of 6 March 2012 in State

[1] OJ C 283, 20.10.2010, p. 1.
[2] OJ C 53, 19.2.2011, p. 4.
[3] OJ C 274, 17.9.2011, p. 5.

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aid case SA.34288 (2012/N)[4] and of 27 July 2012 in State aid case SA.35129 (2012/N)[5].

(3) On 9 January 2013, Lithuania notified a fifth prolongation of the scheme until 30 June 2013.

(4) On 31 January 2013, Lithuania exceptionally accepted that the decision is adopted in the English language.

II FACTS

1. Description of the scheme

Legal basis

(5) The principles of the measures are laid down in the Law on "Financial Stability" (hereinafter "the Law") adopted by the Lithuanian Parliament on 22 July 2009 and published in the Lithuanian Official Gazette on 4 August 2009, No. 93-3985.

(6) The three measures were implemented by a "Resolution on approval of rules on issue, administration and implementation of state guarantees for bank stability enhancement, rules on extension of subordinated loans to banks and supervision thereof and rules on redemption of bank assets". Those rules were adopted by the Government of the Republic of Lithuania on 24 November 2010 and published in the Lithuanian Official Gazette on 27 November 2010, No. 139-7136.

Operation of the scheme

(7) In response to the on-going exceptional turbulence in world financial markets, Lithuania initially brought forward the original scheme consisting of three measures designed to ensure the stability of the Lithuanian financial system and to remedy a serious disturbance in the economy of Lithuania. The guarantee measure aims at enhancing the liquidity of a bank thus strengthening its stability and credibility. The asset relief measure aims at cleaning up balance sheets and restoring the confidence of investors and customers. The recapitalisation measure aims at increasing the stability and credibility of a bank's activities by increasing its regulatory capital base and improving its solvency.

(8) The three measures composing the scheme are as follows:

A. <u>Guarantees</u>: The measure covers the provision of a guarantee, in return for a fee, on newly issued senior loans and other senior financial liabilities, excluding interbank deposits.

B. <u>Recapitalisation</u>: The recapitalisation measure can be granted in the form of subordinated loans with a two- to five-year term, designed to be qualified as Basel II

[4] OJ C 82, 21.3.2012, p. 4.
[5] OJ C 284, 20.9.2012, p. 5.

Tier 2 or Tier 3 capital, depending on their maturity.

C. Asset relief: The Lithuanian State introduced a mechanism for asset relief for banks in order to transfer bank assets to the State-controlled join stock company AB Turto bankas, in exchange for a payment.

(9) Beneficiaries of the scheme are banks whose financial situation poses a threat to the stability and credibility of the banking system, including foreign subsidiaries and branches of foreign banks established in the Republic of Lithuania.

(10) Pursuant to the commitments of Lithuania to monitor the use of the scheme, set out in recitals 57, 59 and 60 of the original decision, Lithuania confirmed in the notification, that no bank has used any of the bank support measures to date.

(11) The terms and conditions of recapitalisation and asset relief remain unchanged as compared to the previous versions of the scheme (the introduction of the scheme and the prolongations). A detailed description of the measures can be found in the original decision (chapters 3A and B).

(12) As regards guarantees on liabilities, the remuneration will be calculated in accordance with the formula set out in the 2011 Prolongation Communication[6], and as described in chapter 2.1 of the Commission Decision in State aid case SA.34288. The Lithuanian authorities provided an indicative fee (estimate) for the period 1 January to 30 June 2013 determined according to the guidance in the 2011 Prolongation Communication. For banks belonging to "A-rating" bucket the indicative fee would stand at 1.09% whereas for banks belonging to "BBB-rating or below" bucket or which are without a rating it would be 1.21%.

2. New elements of the scheme

(13) The annual budget has been reduced to LTL 0.8 billion (EUR 232 million[7]) for the guarantee measure, and to LTL 0.8 billion (EUR 232 million) for recapitalisation and asset relief measures.

(14) With regard to the remuneration of guarantees for debt instruments with a maturity longer than three years, the scheme introduces a new "step up" clause. The annual fee for guarantees on debt instruments with a maturity longer than three years will be increased by 10% as compared to the fee applicable to guarantees on comparable debt instruments with shorter maturities. In turn, debt instruments with a maturity longer than three years are no longer limited to one-third of the scheme's overall budget.

(15) Finally, Lithuania commits that beneficiaries under the scheme will respect a wide range of behavioural commitments in the rescue phase, i.e. until the support is authorised as restructuring aid, such as an acquisition ban, a price leadership ban, a dividend ban, a coupon ban as well as restrictions on remuneration of executives and a regular reporting.

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6 Communication from the Commission on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 356, 6.12.2011, p. 7.

7 Conversion at the exchange rate (EUR 1 = LTL 3.45) as of the date of the notification (9.01.2013).

(16) The full list of applicable commitments is set out in the Annexes to the present decision.

III POSITION OF LITHUANIA

(17) On 9 January 2013, Lithuania notified to the Commission a request to prolong the scheme until 30 June 2013.

(18) Lithuania submits that the scheme constitutes State aid within the meaning of Article 107(1) of the Treaty on the Functioning of the European Union ("TFEU"), but is of the view that the proposed prolongation is compatible with the internal market on the basis of Article 107(3)(b) TFEU as it is necessary in order to remedy a serious disturbance in the economy of Lithuania.

(19) Lithuania submitted a letter by the Bank of Lithuania, dated 26 November 2012, further supporting the need for the proposed prolongation to safeguard the stability of the financial system in Lithuania, because prevailing market conditions do not allow for a termination of the scheme.

(20) Lithuania undertakes to maintain all commitments made since the introduction of the scheme, which the Commission took into account in the original decision, as well as the commitments introduced in the respective prolongation decisions.

IV ASSESSMENT

1 Existence of aid

(21) According to Article 107(1) TFEU, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

(22) For the reasons indicated in the original decision, the Commission considers that the scheme constitutes State aid within the meaning of Article 107(1) TFEU, because it concerns the provision of State resources to a certain sector, i.e. financial sector, which is open to intense international competition. Under the scheme, participating financial institutions obtain guarantees, recapitalisation and asset relief measures under conditions which would not be available to them under market conditions, and so receive an advantage. Given the characteristics of the financial sector, any advantage from State resources to a financial institution affects intra-Union trade and therefore threatens to distort competition. The measure therefore constitutes State aid within the meaning of Article 107(1) TFEU.

2 Compatibility

a) Application of Article 107(3)(b) TFEU

(23) Under the scheme Lithuania intends to provide aid in the form of guarantees, recapitalisation and asset relief measures in favour of banks.

(24) In line with the Banking Communication[8], in order for such aid to be compatible, any aid or aid scheme must comply with the general criteria for compatibility under Article 107(3) TFEU. Viewed in the light of the general objectives of the Treaty, that implies that the measures have to be appropriate, necessary and proportionate.

(25) Given the on-going constraints on the financial markets, the Commission considers it appropriate to examine the measures of the scheme under Article 107(3)(b) TFEU.

(26) Article 107(3)(b) TFEU empowers the Commission to find that aid is compatible with the internal market if it is intended "to remedy a serious disturbance in the economy of a Member State". The Commission has acknowledged that the global financial crisis can create a serious disturbance in the economy of a Member State and that measures supporting banks are apt to remedy that disturbance. That assessment has been confirmed in the Recapitalisation Communication[9], the Restructuring Communication[10] and Impaired Assets Communication[11]. The Commission still considers that requirements for State aid to be approved pursuant to Article 107(3)(b) TFEU are fulfilled in view of the reappearance of stress in financial markets. The Commission confirmed that view by adopting the 2010 Prolongation Communication[12], which prolonged until 31 December 2011 the application of State aid rules to support measures in favour of banks in the context of the financial crisis. The Commission has since extended the application of those rules beyond 31 December 2011 under the 2011 Prolongation Communication.

(27) The Commission considers that the exceptional circumstances at the origin of the notified measures persist and therefore recognises the need for the prolongation of the scheme. The letter from the Bank of Lithuania endorses that necessity (see recital (19)). In particular, the Bank of Lithuania states that the Lithuanian economy is relatively small and open, and focused on export; therefore, any significant setback of the Eurozone countries poses a

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8 Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, OJ C 270, 25.10.2008, p.8.

9 Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against the undue distortions of competition, OJ C 10, 15.1.2009, p. 2.

10 Commission Communication on the return to viability and the assessment of the restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009, p. 9.

11 Communication from the Commission on the treatment of impaired assets in the Community banking sector, OJ C 72, 26.3.2009, p. 1.

12 Communication from the Commission on the application, from 1 January 2011, of State aid rules to support measures in favour of bank's in the context of the financial crisis, OJ C 329, 7.12.2010, p. 7.

threat to the stability of the Lithuanian financial system. Hence, the Commission finds that the scheme aims at remedying a serious disturbance in the Lithuanian economy.

(28) Therefore, the Commission continues to base its assessment of State aid measures in the banking sector on Article 107(3)(b) TFEU.

b) Assessment of the recapitalisation measure

(29) The assessment of the recapitalisation measure has not changed compared to the assessment in the original decision (see recitals (96) to (107)).

Appropriateness

(30) The objective of the scheme is to temporarily offer appropriate measures to establish backstops for the financial system in a timely and efficient manner, where private solutions for strengthening the capital base fail. The Commission observes that applicable prudential requirements have recently been significantly increased by the European regulators. That development has given rise to concerns about the creditworthiness of certain financial institutions. Hence, a backstop mechanism by the Member State to address a shortfall of Tier-2 capital is an appropriate means to strengthen financial institutions helping them to meet the total capital requirement and thus to restore market confidence[13].

Necessity

(31) With regard to the scope of the measure, the Commission notes positively that Lithuania has limited the budget available for recapitalisations and that the scheme applies for a limited time, until 30 June 2013. The Commission has also taken into account the type of capital provided and its limited duration (i.e. the term of subordinated loans is fixed ex ante and cannot be longer than five years) as well as the commitment to present either a restructuring or a liquidation plan for banks in difficulty within six months. Therefore, the Commission considers the measure as limited to the minimum necessary.

(32) In particular, the Commission seeks to ensure that there is an appropriate remuneration for the capital provided by the State, which is market-oriented[14]. In that context, Lithuania will charge an interest rate consisting of the sum of i) the yield of comparable government bonds; ii) Republic of Lithuania 5 year CDS and iii) an additional 200 basis points. The Commission observes that the calculation method results in an interest rate of about 10.13% for loans provided in litas and 8.27% for loans in euro, taking into account prevailing market rates as of December 2012. That remuneration exceeds remuneration based on the methodology followed in the Recapitalisation Communication and recommended by the ECB (see recitals (103 and 104 of the original decisions), therefore, the Commission considers that the expected return can be considered acceptable in the present case.

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[13] With entering into force of the new Capital Requirement Directive IV package, Tier-2 capital instruments will continue to be included in the total capital requirement. Tier-3 capital instruments remain eligible for the total capital calculation until that new legislation enters into force.

[14] In line with the Banking Communication, point 39.

Proportionality

(33) The Commission notes that Lithuania has committed to a number of behavioural safeguards to apply already in the rescue phase, i.e. for the period from the recapitalisation until the Commission adopts a restructuring decision. In particular, Lithuania submitted the following behavioural commitments: an acquisition ban, a dividend ban, a hybrid coupon ban, and a cap on management's remuneration. Those commitments ensure adequate burden-sharing already in the rescue phase and prevent the beneficiary from using the aid to finance anti-competitive behaviour or activities, which are not necessary for restoration of its viability. The Commission welcomes the implementation of the restructuring principles already at a preliminary stage, given that the analysis of a restructuring plan often takes considerable time.

(34) Finally, the Commission welcomes that Lithuania undertakes to submit a restructuring plan for any bank which benefits from a recapitalisation, in line with the rules set out in the 2010 Prolongation Communication. The Commission also welcomes the fact that Lithuania undertakes that the restructuring plan to be submitted will comply with the principles set out in the Restructuring Communication in order to re-establish the individual bank's long-term viability without reliance on State support, while containing adequate burden-sharing measures and measures to limit distortions of competition.

(35) As regards the combination of the scheme with other aid measures, the Commission recalls that, as indicated in the Annex to the Restructuring Communication, the restructuring plans to be submitted should contain all State aid received as individual aid or under a scheme during the restructuring period.

(36) Furthermore, based on point 16 of the Restructuring Communication, the Commission recalls that should further aid not initially foreseen in a notified restructuring plan be necessary for the restoration of viability, it cannot be granted under an approved scheme but needs to be subject to individual ex ante notification and any such further aid will be taken into account in the Commission's final decision on that bank.

c) Assessment of the guarantee measure

(37) The objective of the guarantee measure is to provide a safety net for investors in newly issued debt of participating banks in Lithuania, so that such banks can have sufficient access to liquidity.

Appropriateness

(38) The guarantee measure is a reaction to the on-going constraints on the financial markets in which even banks without intrinsic problems are facing difficulties in gaining access to liquidity. In the previously approved schemes, the Commission has established that such a guarantee scheme can be a suitable means to address those problems. Thus, the Commission considers the guarantee measure appropriate to address possible constraints in refinancing which may cause a potential serious disturbance in Lithuania's economy.

Necessity

(39) As regards necessity, the Commission notes positively that the guarantee measure is limited to new debt and only applies for a limited time, until 30 June 2013. Therefore, the Commission considers the measure as limited to the minimum necessary.

(40) The distortion of competition is minimised by various safeguards. Above all, the excessive use of guarantees is discouraged by the requirement to pay a market-oriented premium. The Lithuanian authorities have given a commitment that the minimum level of such remuneration will be determined according to the rules set out in the 2011 Prolongation Communication as indicated above.

(41) In fact, the pricing formula introduced by Lithuania takes into account the greater differentiation by risk of banks' CDS spreads in recent times, by referring to median CDS spreads over a three-year period ending one month before the granting of guarantees.

Proportionality

(42) As regards proportionality, the annual fee for guarantees on debt instruments with a maturity longer than three years will be increased by 10% as compared to the fee applicable to guarantees on comparable debt instruments with shorter maturities. That step-up clause constitutes a disincentive for benefitting banks to resort to State guarantees for debt instruments with maturities longer than three years. Thus, that clause is contributing to reduce the distortions of competition caused by the measure.

(43) Furthermore, Lithuania undertakes to submit an individual notification if a restructuring plan has already been submitted by the beneficiary bank that did not foresee the envisaged guarantee. Lithuania also agrees to submit a viability review for any bank that requests new guarantees under a scheme which take or keep the total amount of the bank's outstanding guaranteed liabilities above 5% of the bank's total liabilities and above the absolute amount of EUR 500 million. That commitment ensures that the use of guarantee scheme will not enable banks with structural weaknesses in their business models to postpone or avoid the necessary adjustments.

(44) The Commission welcomes that Lithuania undertakes to submit individual restructuring or liquidation plans, within six month, for banks which cause the guarantee to be called upon.

(45) On the basis of those considerations, the prerequisites for the compatibility of guarantee schemes that have been established by the Banking Communication and the 2011 Prolongation Communication are met.

d) Assessment of the asset relief measure

(46) The assessment of the asset relief measure has not changed compared to the assessment in the original decision (see recitals (72) to (95)). The objective of the asset relief measure is to clean up balance sheets and restore a bank's solvency, which is an effective way of supporting ailing banks and thus an appropriate means of overcoming the difficulties on

financial markets. As the measure complies with the criteria of full ex ante transparency and disclosure, eligibility of assets, alignment of incentives to participate with public policy objectives, asset management arrangements, burden-sharing and remuneration, and that proper follow-up is ensured, the measure can still be considered compatible.

(47) Lithuania has sustained the commitment to provide a restructuring plan for all beneficiaries of the asset relief measure within three months from the beneficiary's accession to the scheme[15].

e) Monitoring

(48) Finally, the Lithuanian authorities reiterated their commitment to comply with the reporting obligations under the 2011 Prolongation Communication and, in addition, to provide quarterly reports on all measures granted under the scheme and a list of all beneficiaries.

f) Conclusion on the compatibility of the aid measure

(49) In view of the above, the fifth prolongation of the Lithuanian bank support scheme remains an appropriate, necessary and proportionate measure to remedy a serious disturbance in the Lithuanian economy and does not alter the Commission's previous assessment in the decision of 5 August 2010[16] and the subsequent prolongation decisions. In light of the commitments set out in the Annexes to this decision, the notified prolongation complies with the requirements set out above and is compatible with the internal market pursuant to Article 107(3)(b) TFEU.

(50) In line with the Commission's decisional practice the Lithuanian bank support scheme can therefore be prolonged until 30 June 2013. Any further prolongation will require the Commission's approval and will have to be based on a review of the developments in financial markets and the scheme's effectiveness.

(51) The notified prolongation of the Lithuanian bank support scheme is, in light of the commitments set out in the Annexes to this decision, compatible with the internal market pursuant to Article 107(3)(b) of the Treaty on the Functioning of the European Union, until 30 June 2013.

15 See Decision of 27 June 2011 in State aid case SA.33135 (2011/N) recital 28.

16 See footnote 1.

CONCLUSION

The Commission has accordingly decided:

- to consider the aid to be compatible with the internal market.

Lithuania exceptionally accepts that the present decision be adopted in the English language, for reasons of urgency.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: http://ec.europa.eu/competition/elojade/isef/index.cfm

Your request specifying the relevant information should be sent by registered letter or fax to:

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Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President

Annex I

Commitments relating to Guarantee measures

With regard to the prolongation of Lithuanian bank support scheme for the first half of 2013, and specifically to the guarantee measure thereof,

LITHUANIA commits:

- to grant aid measures under the support scheme only to solvent financial institutions which meet capital requirements;
- to grant the guarantees under the support scheme only for new issuance of commercial bank senior debt (subordinated debt is excluded);
- to provide guarantees only on debt instruments with maturities from three months up to five years (or a maximum of seven years in the case of covered bonds). The annual fee payable for guarantees on debt instruments with a maturity longer than three years will be increased by 10% as compared to the fee applicable to guarantees on comparable debt instruments with a maturity of one to three years;
- to impose a ban on advertising referring to the State support on the beneficiaries of the scheme and to prevent them from employing any aggressive commercial strategies, which would not take place without the State support;
- to submit an individual notification if a restructuring plan has already been submitted that did not foresee the envisaged guarantee or liquidity measure;
- to submit individual restructuring or liquidation plans, within six months, for banks which cause the guarantee to be called upon;
- to determine the minimum level of State guarantee remuneration in line with the formula set out in the Commission's Communication on the application, from 1 January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis[17] ("the 2011 Prolongation Communication");

[17] OJ C 356, 6.12.2011, p. 7.

- to communicate to the Commission, within three months following each issuance of guaranteed bonds, the actual fee charged;
- to report on the operation of the scheme and on guaranteed issuance by 15 April 2013 (for the period 1 January 2013 to 31 March 2013) and by 15 July 2013 (for the period 1 January 2013 to 30 June 2013) at the latest;
- to complement reports on the operation of the scheme with updated available data on the cost of comparable (nature, volume, rating, currency) non-guaranteed debt issuances;
- to present a viability review for every financial institution that is granted guarantees on new liabilities or renewed liabilities for which, at the time of the granting of new guarantee, the total outstanding guaranteed liabilities (including guarantees accorded before the date of this decision) exceed both a ratio of 5% of total liabilities and the total amount of EUR 500 million. The viability review should be presented on the basis of the parameters established in the Restructuring Communication[18] within three months of the granting of the guarantees.

[18] Commission Communication on the return to viability and the assessment of the restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009, p. 9.

Annex II

Commitments relating to Recapitalisation measures

With regard to the prolongation of Lithuanian bank support scheme for the first half of 2013 LITHUANIA commits:

- to ensure that recapitalisation provided by the State will not exceed the amount of the recapitalisation determined by the Bank of Lithuania to be necessary;

- to impose a ban on advertising referring to the State support on the beneficiaries of the scheme and to prevent them from employing any aggressive commercial strategies, which would not take place without the State support;

- to impose a dividend ban on the beneficiaries of the scheme for the rescue period, i.e. until the Commission adopts a restructuring decision.

- to ensure that the scheme entails pre-defined maximum limitations in the monetary remuneration (fixed and variable) policy for the members of the bodies and management of the beneficiaries of the scheme;

- to ensure that the beneficiaries of the scheme will not pay coupon on hybrid capital during the rescue period, i.e. until the Commission adopts a restructuring decision, where they have no legal obligation to proceed with such payment. Coupon on hybrid capital held by the State may be paid, unless such payments would trigger coupon payments that otherwise not be obligatory to other investors;

- to submit a restructuring plan for any financial institution which benefits from a recapitalisation after 31 December 2012 within six months from the date of granting the aid (unless the European Commission requests the plan sooner in line with point 14 of the 2011 Prolongation Communication[19]), irrespective of whether pursuant to the rules set out in the Recapitalisation Communication[20] that beneficiary of the scheme is considered to be fundamentally sound or distressed. Lithuania undertakes that the restructuring plan to be submitted shall comply with the principles set out in the Restructuring Communication[21] in order to re-establish the individual financial institution's long-term viability without continued reliance on State support, while containing adequate burden-sharing measures and measures to limit distortions of competition;

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[19] Communication from the Commission on the application, from January 2012, of State aid rules to support measures in favour of banks in the context of the financial crisis, OJ C 356, 6.12.2011, p. 7.

[20] Commission Communication - Recapitalisation of financial institutions in the current financial crisis: limitation of the aid to the minimum necessary and safeguards against undue distortions of competition, OJ C 10, 15.1.2009, p. 2.

[21] Commission Communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009, p. 9.

- to notify individually any aid to a beneficiary of the scheme which has already received recapitalisation aid in the past and needs to approach the scheme for further support;

- to present every six months a report on the implementation of the scheme, including the list of all beneficiaries of the scheme and all the relevant information.

- to impose a ban on the beneficiaries of the scheme acquiring any stake in any undertaking. That prohibition covers both undertakings which have the legal form of a company and packages of assets which form a business. That ban will apply for the rescue period, i.e. until the Commission adopts a restructuring decision. Despite the ban, a beneficiary may acquire stakes in undertakings provided that the purchase price paid for any acquisition is less than 0.01% of the balance sheet size of the beneficiary at the date of the recapitalisation and that the cumulative purchase prices paid for all such acquisitions over the whole restructuring period is less than 0.025% of its balance sheet size at the date of the recapitalisation. The ban does not cover acquisitions that take place in the ordinary course of the banking business in the management of existing claims towards ailing firms.

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